

# Dashboard

Macro Advisor Snapshot  
Fall, 2013

## Dashboard – Mexico (Fall 2013)

### **Economic activity trending quickly lower –rapid recovery unlikely**

- Marginally better US/EU/Asia mftr data may provide near-term lift...
- ...but economy is vulnerable to sustained lower household demand.
- Weak services activity means domestic slow-down less responsive to global mftr bounce

### **Lower inflation creates space for additional policy easing**

- Core CPI in lower band of Banxico's target range for the past 6 months
- PPI also weaker—indicating price trend extends upstream
- Banxico has twice cut rates—warns of greater downside risk to growth

### **Opportunities we are pursuing**

- Equities: Short Mex IPC against long MSCI Emerging Markets (MXEF)
- Currencies: Long MXN against CAD and AUD
- Fixed Income: 2's/10's flattener on weak growth/inf'l (partial US rate risk hedge at long-end)

Iron Harbor Capital Management (CTA, CPO)

info@iharborcap.com  
www.iharborcap.com



## Iron Harbor Open Market - Dashboard

Collecting and processing the vast amount of relevant data that determine global trends is the great challenge of executing a global allocation (macro) strategy. In order to produce high quality returns, an investment team needs an established procedure for collecting data, converting it into information, and then forming investment themes based on that information.

Our economic database—Dashboard—consists of twenty countries and another thirty individual global economic data series. It is the foundation of our primary research effort and a key input that **Chris Nicholson, CFA** and I use in our investment process. Our senior markets analyst, **Eva Yun**, plays an important role in the design and maintenance of this database which ensures procedural consistency and discipline in idea generation.

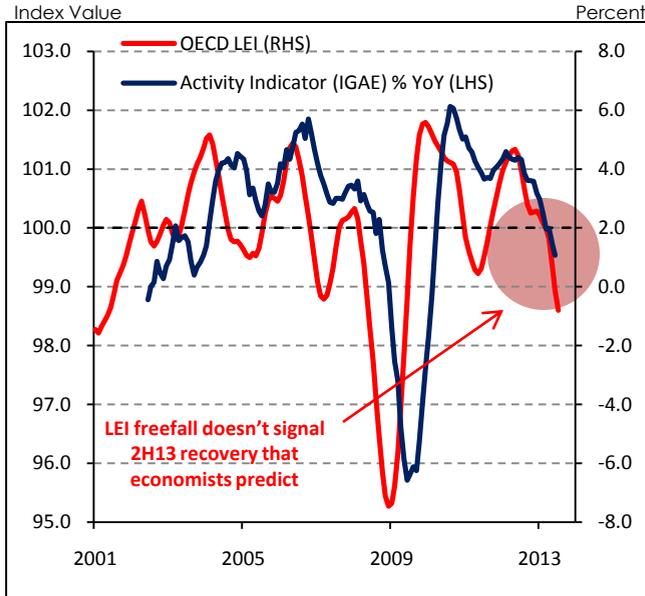
In Open Market–Dashboard, we will present regular snapshots of the trends on which we are focusing. This series will complement our other research efforts by providing investors with a short-form summary of themes and ideas that will impact global investment trends over time.

*Gravelle Pierre, CFA*



# Figure 1. Headline Activity (and Unbridled Optimism) Feeling Some Downside Pressure

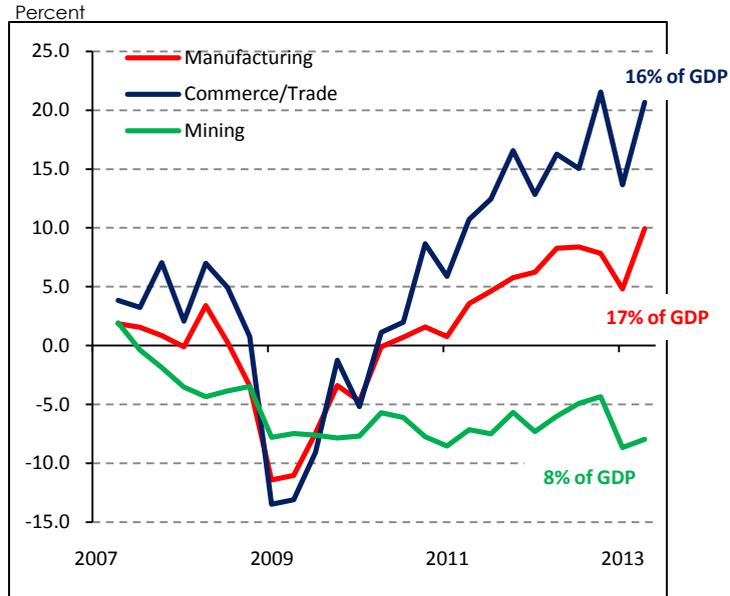
### Mexico activity comes to a halt



Source: INEGI, OECD

Notes: Economy contracted in 2Q for 1<sup>st</sup> time in 4 years....and a slate of growth revisions ensued. The gov't lowered 2013 estimate to 1.8% from 3.1%. BdM cut 2013 a full point to 2-3%. Mexico faces uphill battle to reverse weak growth with slow external demand (US), weak domestic fundamentals (jobs, credit growth, consum. confdnce), and slow gov't spend in early '13. Expec of 2H recovery are misplaced.

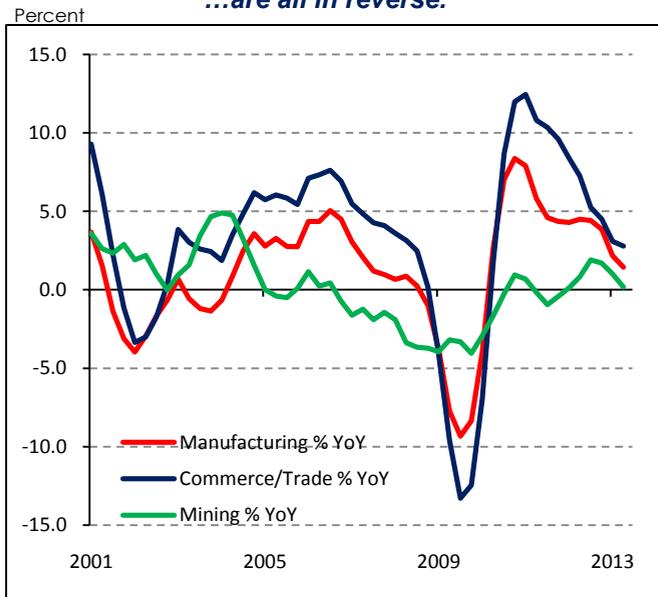
### Key growth drivers of the past 4 years...



Source: INEGI

Notes: Several factors could make Mexico a global manufacturing hub. Labor & energy cost advantages relative to China/emerging Asia and proximity to US give Mexico a competitive edge that global mfrs can exploit. Mexico also has more free trade agreements (44) than any other country...makes greater FDI easy call for multi-nationals.

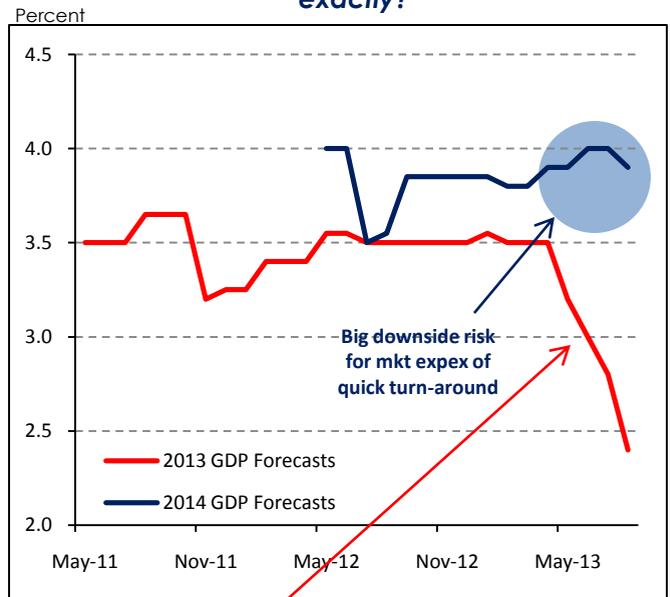
### ...are all in reverse.



Source: INEGI

Notes: 2Q GDP notable for decline in svc sector...1<sup>st</sup> drop since '08-09 crisis. Weak domestic svcs suggests slowdown not lim'd to 1<sup>st</sup>-round effects of slow external demand.

### And we pay economists to do what exactly?



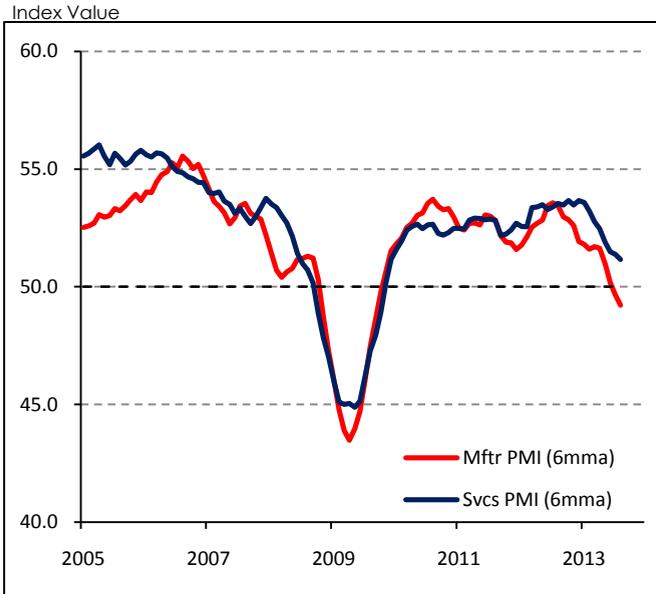
Source: Bloomberg

Notes: **No one got this right.** Rising expex for growth in major developed econs propping up '14 estimates. While better external demand may support growth over m/t, 2<sup>nd</sup> order slump in domestic demand to disappoint '14 expex.

## Figure 2. Second-Half Unlikely To Be As Bad As First-Half (but rapid recovery unlikely)



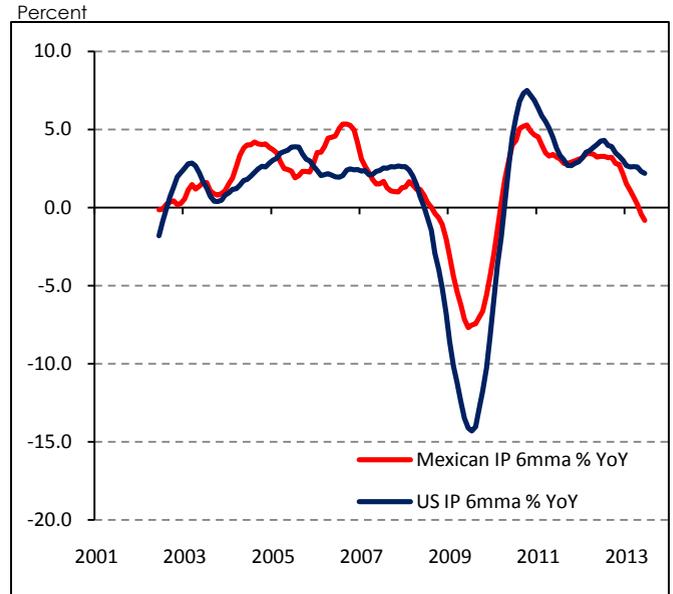
### Business surveys losing momentum...



Source: INEGI, OECD

Notes: IMEF PMI trend steadily lower, reflects cycle lows touched in July. Moderate Aug. rebound due to slightly better domestic new orders while new export work lower for 4<sup>th</sup> consec. month. In light of recent strong US/EUR PMI's (on new orders and produx) and Mex gov't spending projects to come on-line over next several quarters, upside risk exists for PMI. On the downside, global growth looks shaky and HSBC-Markit EM PMI at stall-speed...near 4 year lows.

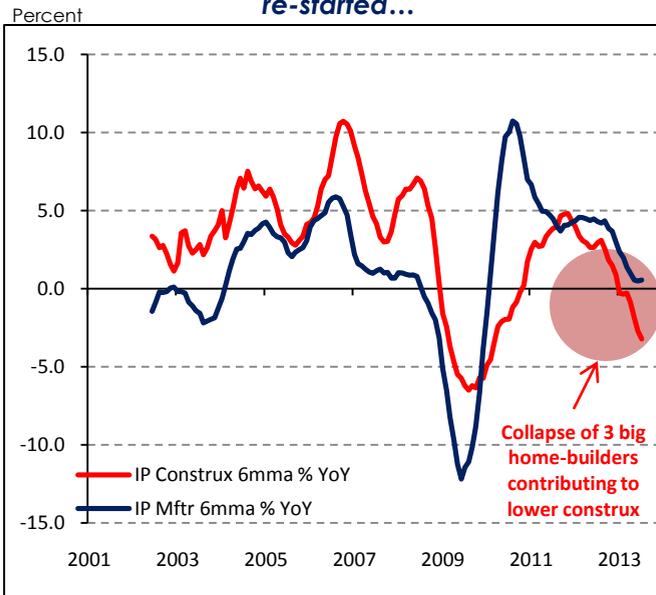
### ...and point to further slowdown.



Source: INEGI

Notes: Over time Mexico's GDP growth tends to correlate closely to US IP...which pulled back in the spring on government spending cuts and weak global demand. 2H13 US data is questionable despite big IP gains in August from a low base in 2012. But, with global [auto boom](#), marginally better Europe/China activity, and Mex infrastructure spend, Mex [construction](#) and manufacturing in 2H13 will get support.

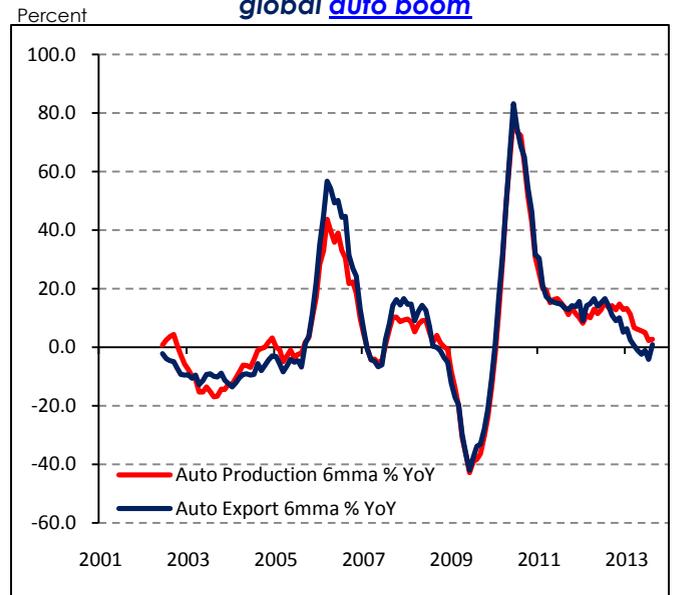
### China-style investment spend could get the party re-started...



Source: INEGI

Notes: In mid-July, Nieto revealed plans to upgrade telecom/transpo infrastrux with \$102 billion [spending package](#). Including the pvt sector, total spend could hit \$314B btwn '13-'18...larger than last 6-yr plan of \$230B.

### ...in the context of the ongoing global auto boom



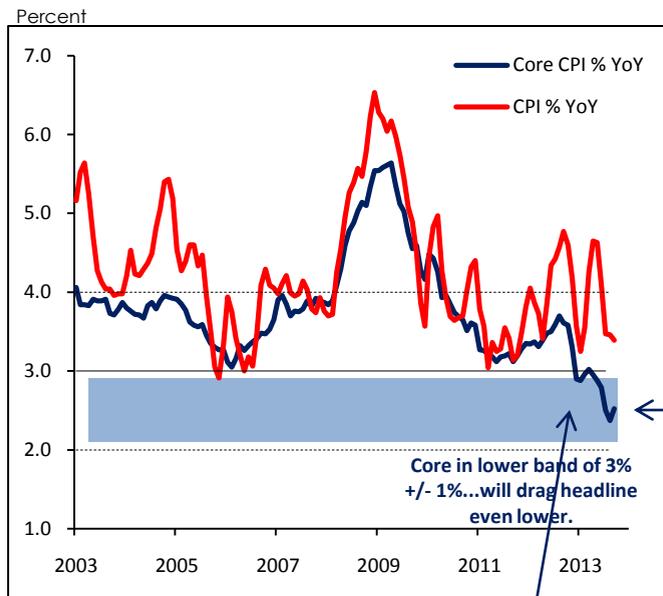
Source: AMIA

Notes: US domestic auto sales flat MoM during 1H13, albeit at a high level (~12mm saar)...Mex % YoY auto produx likewise slowed. US demand now firmer; low rates = best monthly sales in [6 years](#), should lead MEX production rebound.



## Figure 3. Prices Trending Quickly Lower (and that's not the sign of a healthy economy)

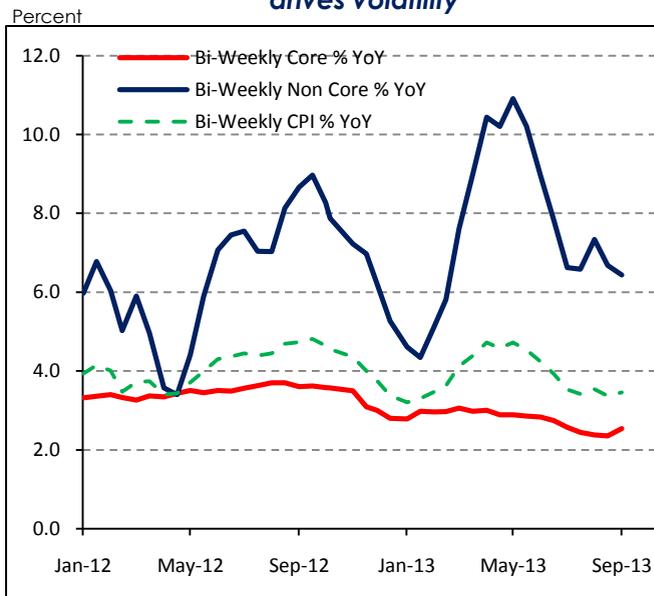
### Core falls off a cliff



Source: INEGI

Notes: The trend in core inflation is convincingly lower and reflects [weaker domestic activity](#) (see employment/retail sales). The move lower in core CPI is notable because it is the first time in 10 years that the series has moved to the lower band of Banxico's inflation target...not a sign of a healthy domestic economy.

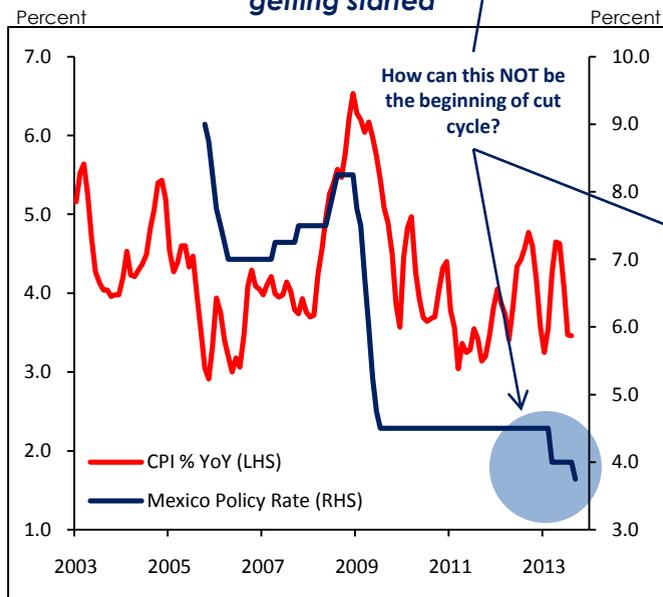
### Bi-weekly data shows non-core drives volatility



Source: INEGI

Notes: Recent bi-weekly inflation data shows that non-core CPI is leading the charge lower in inflation and, in fact, explains most of the volatility in the headline number. Most of that volatility is due to record vegetable/fruit crop yields that have driven prices lower after a poor harvest in 2012 (similar to the US). Previously, Banxico has 'looked thru' near term CPI vol...meaning, their decision function has ignored non-core prices.

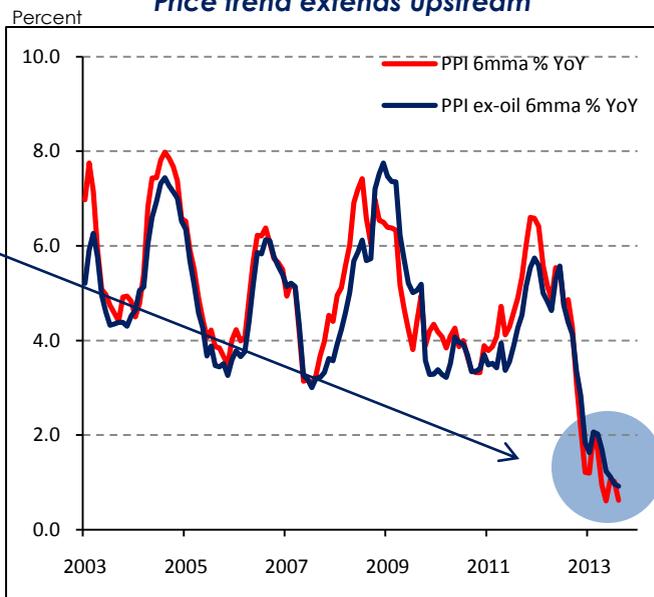
### Banxico rate cut cycle just getting started



Source: INEGI, Bloomberg

Notes: [Banxico acknowledged](#) the impact of ag prices on headline CPI but then added that core inflation was lower over most of 2Q and that surveyed market participants see no significant inflationary pressures over the next 12 months.

### Price trend extends upstream



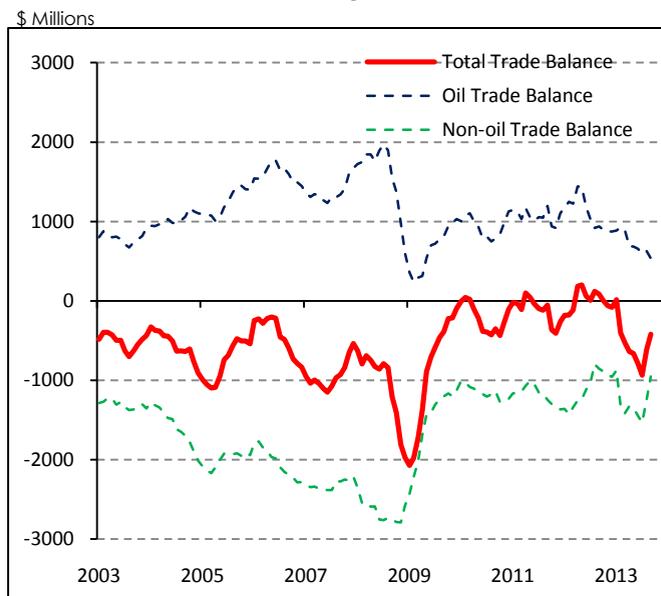
Source: INEGI

Notes: PPI has been shown to have [significant predictive content](#) for subsequent developments in CPI....meaning that headline CPI likely has further downside.



## Figure 4. Balance of Payments: So Far, So Good (and much better than most EMs)

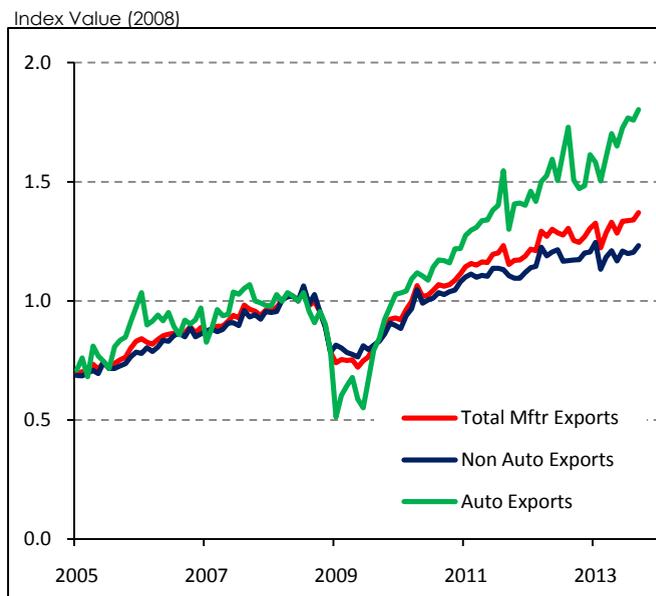
### Oil exports a big factor in BoP...



Source: Banxico

Notes: Although Mexico's trade balance is marginally negative, it will likely improve as US auto demand firms in 4Q (autos account for 24% of total exports). [Oil/energy exports](#), however, bear close watch with declining production and lower prices introducing balance of payments risk.

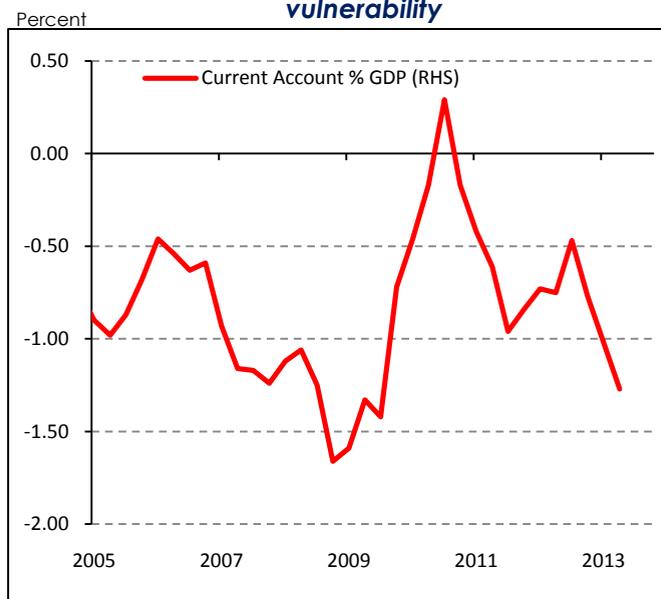
### ...as well as auto exports.



Source: Banxico

Notes: Auto exports have been the key driver behind Mex manufacturing and exports. Record low US auto loan rates and an aging fleet (despite changing driving habits) have spurred US demand for cars, which represent 80% of Mex auto exports. Record levels of investment by foreign auto companies (which are making Mex a mfr hub in the Americas) hoping to get in on the action while it lasts.

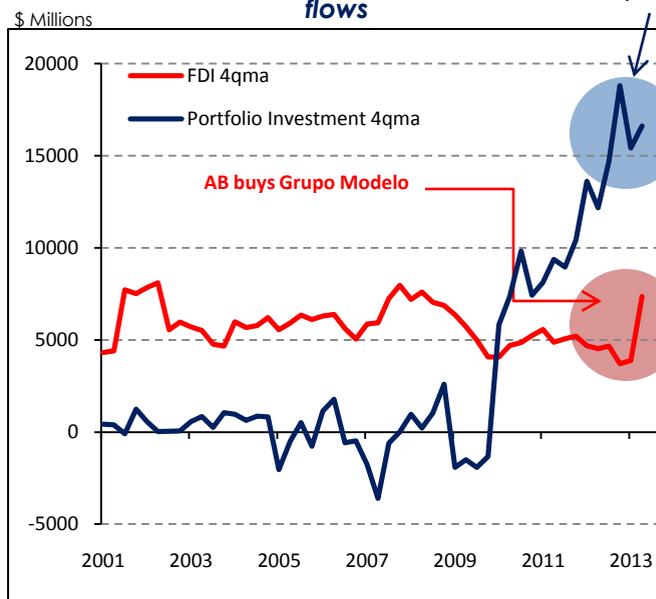
### Current account doesn't signal vulnerability



Source: Bloomberg

Notes: Moderate C/A deficit vs. other mid-income economies (TRY -6.62%, BRL -2.43%, INR -5.35%, IND -2.81%, ZAR -6.51%) to insulate Mexico in case of [emerging market crisis](#). Large sticky FDI from global automakers to add greater stability.

### FDI may hold, but watch portfolio flows



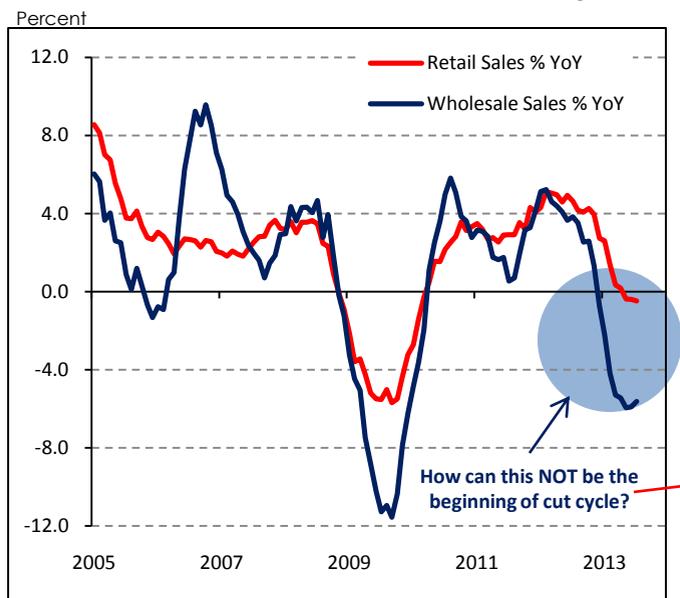
Source: Banxico

Notes: Data thru 2Q capture some degree of Fed taper bomb in late May and resulting EM outflows...more to come in 3Q. Mex in better shape than other EMs due to [auto manufacturers](#). More [investment](#) due if Pemex reforms pass.



## Figure 5. Household Sector Is Vulnerable

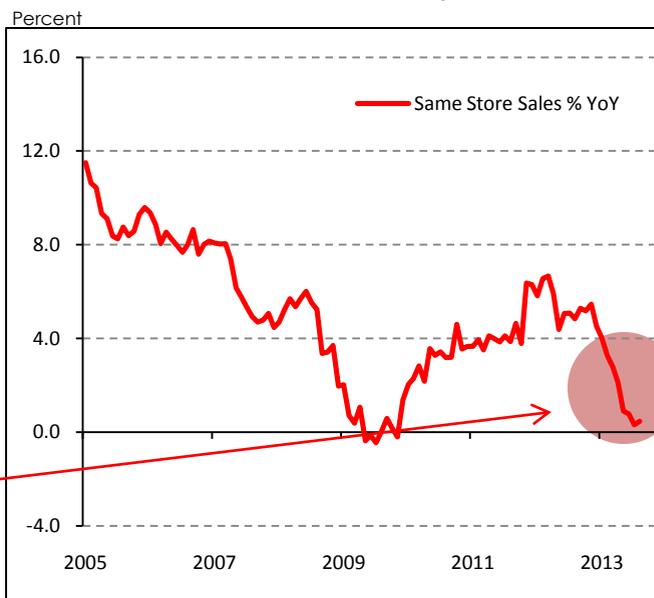
### Households hit the breaks on spending...



Source: INEGI

Notes: Broader activity throughout North America dipped at end 2Q/beginning 3Q, but has since staged a moderate recovery. Thus, it is no surprise that Mex domestic sales also retreated over the same period. We consider a further extended decline in sales as unlikely as a quick return to 2012's robust pace...rather, weak underlying factors are likely to keep demand muted through 1H2014. Keep an eye on [los remesas](#) which had trended lower for 13 consecutive months.

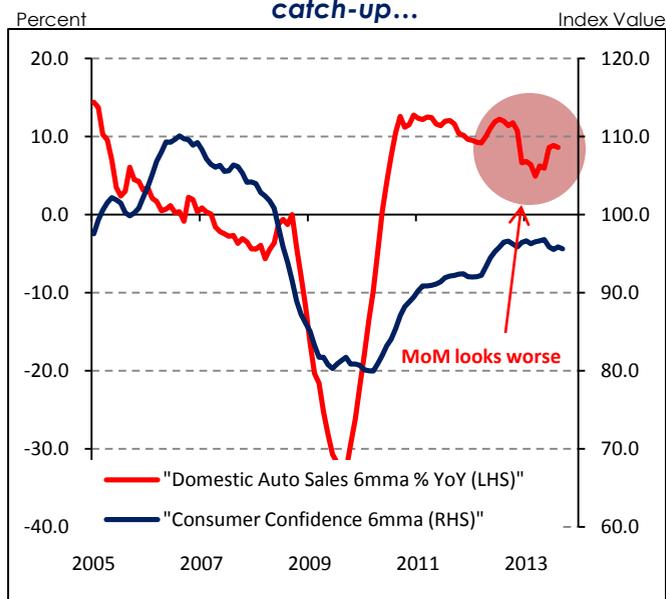
### ...and retailers think it's not just temporary



Source: ANTAD

Notes: Walmart and Controladora Comercial (Mex's 1<sup>st</sup> and 3<sup>rd</sup> largest retailers) plan to cut investment by between [12% and 50%](#) over upcoming year...suggests a more serious slowdown to the domestic economy and one that might be less immediately responsive to better US auto purchases. [Hurricanes](#) Ingrid and Manuel which struck in September will further depress sales over the near-term.

### Confidence and auto sales playing catch-up...



Source: INEGI, AMIA

Notes: Domestic auto sales had been somewhat steady until a big MoM drop in Sep. at the same time that confidence tumbled lower...the 6mma's in both series are clearly losing momentum that will begin to tilt lower in 4Q.

### ...as job growth loses momentum.



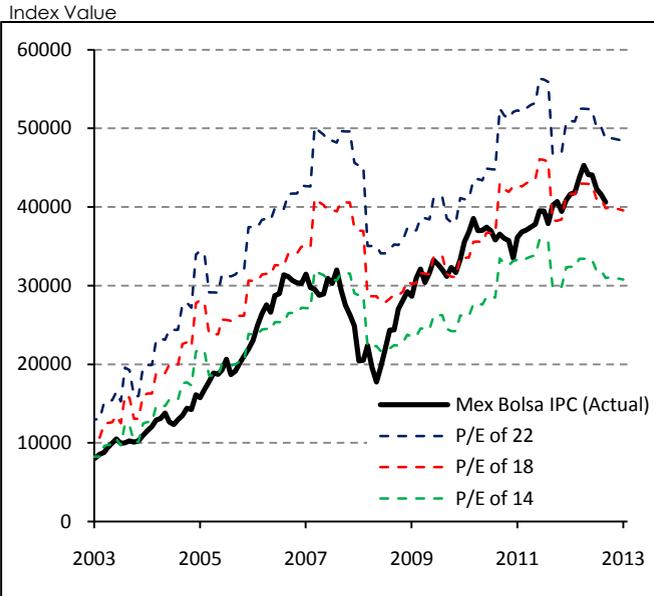
Source: INEGI

Notes: [Weak job creation](#) due to: 1) slower exports to the US, 2) slower start to G spending and 3) collapse of Mex's 3 largest low-income housing companies, which used to employ thousands of workers.

# Figure 6. Despite Faster Growth Potential, Mexico Nearly Fully Priced



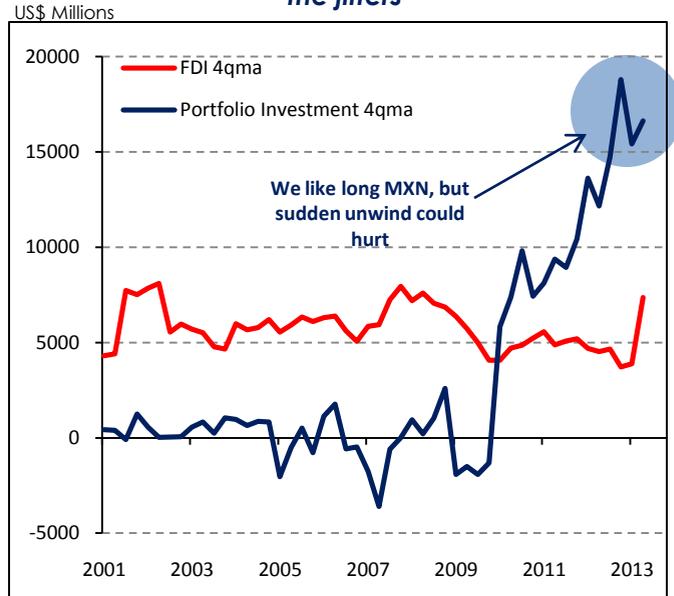
## Valuations are not inexpensive



Source: Bloomberg

Notes: IPC fully valued fwd P/E at 17.51 vs. SPX (15.25) and MXEF (11.40). P/B at 2.63 also looks pricey relative (SPX 2.17, MXEF ~1.6).

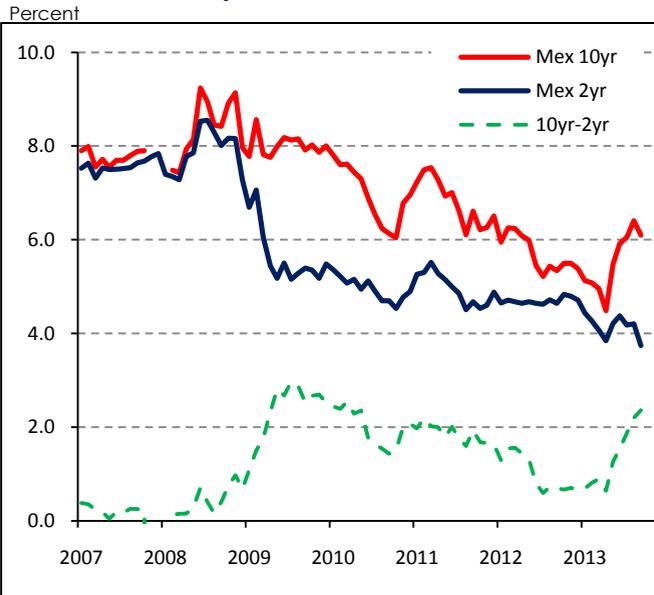
## Wall of money that flooded Mexico could get the jitters



Source: Banxico

Notes: Fed taper talk in May only partly reflected in 2Q investment flows and doesn't bode well for 3Q. [Portfolio investment](#) was -\$9mm in 2Q from +\$13.2B in 1Q. Stocks/corp bonds saw -\$4.9B vs. +\$29mm in Aztec Tiger 1Q. FDI higher on AB purchase of Grupo Modelo....but bears close attention to 3Q data.

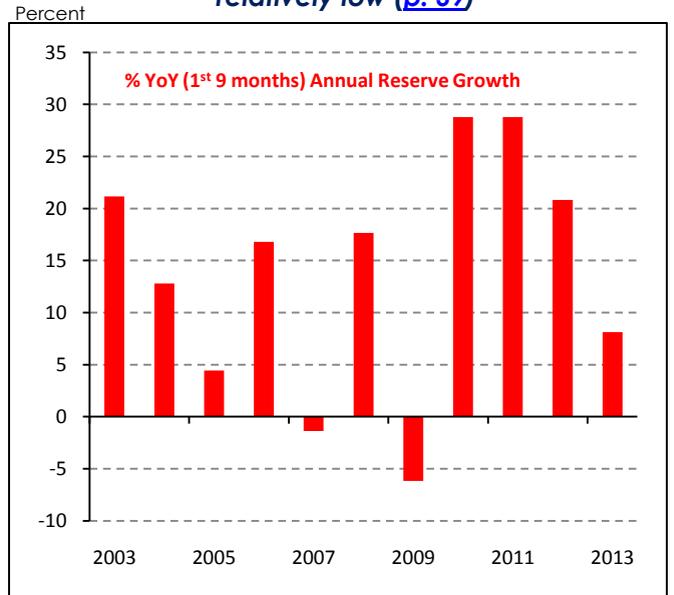
## Mex yield curve set to flatten



Source: Bloomberg

Notes: Given the tepid pace of US growth and low CPI, we expect there is little upside risk for US rates from here, despite the certainty of Fed taper. Given weak Mex domestic outlook, we expect curve flattener over upcoming quarters.

## International reserve holdings relatively low (p. 39)



Source: Bloomberg

Notes: Reserve growth (driven largely by Pemex) at risk on declining oil prices/produ. Still, key ratios (rsvs to imports/M2/s.t. debt) look better than the [fragile five](#).

## Iron Harbor Open Market-Dashboard

**Gravelle Pierre** is the Founder and Portfolio Manager of Iron Harbor.

**[gpierre@iharborcap.com](mailto:gpierre@iharborcap.com)**

**Jacqueline Hayot** is the Operating Officer of Iron Harbor.

**[jhayot@iharborcap.com](mailto:jhayot@iharborcap.com)**

**Christopher Nicholson** is the Senior Portfolio Strategist of Iron Harbor.

**[cnicholson@iharborcap.com](mailto:cnicholson@iharborcap.com)**

**Eva Yun** is the Senior Markets Analyst of Iron Harbor.

**[eyun@iharborcap.com](mailto:eyun@iharborcap.com)**

**Iron Harbor Capital Management IS NOT offering these views as a solicitation for investment.**